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[REDACTED] - Foreign base company shipping income

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This memorandum is in response to your request for informal assistance with regard to the following facts.

FACTS:

[REDACTED], a U.S. corporation, owns four separate chains of subsidiary corporations. In chain A, [REDACTED] (" [REDACTED] "), a U.S. corporation, owns all of the stock of [REDACTED] (" [REDACTED] "), a foreign corporation, which owns all of the stock of two foreign brother-sister corporations, [REDACTED] (" [REDACTED] ") and [REDACTED] (" [REDACTED] "). In chain B, [REDACTED] (" [REDACTED] "), a U.S. corporation, owns all of the stock of [REDACTED] (" [REDACTED] "), a foreign corporation. In chain C, [REDACTED] (" [REDACTED] "), a U.S. corporation, owns all of the stock of [REDACTED] (" [REDACTED] "), a foreign corporation, which owns all of the stock of [REDACTED] (" [REDACTED] "), a foreign corporation. In chain D, [REDACTED] (" [REDACTED] "), a foreign corporation, is wholly owned directly by [REDACTED].

For the [REDACTED] taxable year, [REDACTED] elected to treat [REDACTED], [REDACTED], [REDACTED], [REDACTED], and [REDACTED] as members of a related group pursuant to section 955(b)(2) of the Internal Revenue Code and section 1.955A-3 of the Income Tax Regulations.

For the [REDACTED] taxable year, [REDACTED], [REDACTED], [REDACTED], and [REDACTED] earned foreign base company shipping income that

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together totalled \$ [REDACTED]. [REDACTED] and [REDACTED] had foreign base company shipping losses of \$ [REDACTED] and \$ [REDACTED], respectively. \$ [REDACTED] of [REDACTED]'s loss and \$ [REDACTED] of [REDACTED]'s loss were used to reduce the related group's foreign base company shipping income to zero. [REDACTED] used the remaining \$ [REDACTED] of its loss to offset the subpart F income of [REDACTED], the CFC that directly owned all of [REDACTED]'s stock, pursuant to section 952(d), as then in effect.

ISSUES:

(1) Does the related group election apply for purposes of determining the foreign base company shipping income of each member of a related group even when there has been no increase or decrease in qualified investments in foreign base company shipping operations by any member of the group?

(2) Can a CFC use its foreign base company shipping loss "horizontally" to offset the foreign base company shipping income of members of its related group under section 1.955A-3 and then use the unused portion of this loss "vertically" to offset the subpart F income of a CFC in the same chain of ownership?

LAW & ANALYSIS:

I. Scope of related group election

Section 955(b)(2) of the Code provides that for purposes of determining the amount of qualified investments in foreign base company shipping operations, an investment or decrease in investment by one or more controlled foreign corporations may, under regulations prescribed by the Secretary, be treated as an investment or decrease in investment by another corporation which is a CFC and is a related person with respect to the corporation making or withdrawing the investment.

Although section 955(b)(2) of the Code refers only to one purpose for the group election, determining the amount of qualified investments in foreign base company shipping operations, the regulations under section 955 are broader in scope. Section 1.955A-3(c) of the regulations provides that if a U.S. shareholder elects to treat two or more controlled foreign corporations as a related group for any group taxable year then, for purposes of determining the foreign base company income (see §1.954-1) and the increase or decrease in qualified investments in foreign base company shipping operations of each member of the group for the year, the rules provided in section 1.955A-3(c)(1) through (c)(5) will apply.

The legislative history of section 955(b)(2) of the Code supports the broad scope of the regulations. The House Report provides:

[i]t is intended that these regulations [under section 955(b)(2)] will establish rules under which a group of related corporations will combine their foreign base company shipping income and their qualified investments for purposes of determining income subject to current taxation as subpart F income, their increase in qualified investments, and their withdrawals from qualified investments.

H.R. Rep.93-1502, 93d Cong., 2d Sess. at 139.¹ Accordingly, the related group election under section 955(b)(2) and section 1.955A-3 of the regulations applies for purposes of determining the foreign base company shipping income of the members even when there is no increase or decrease in qualified investments in foreign base company shipping operations of any member of the group.

II. Horizontal and vertical use of losses

Prior to its repeal in 1986, section 952(d) provided that for purposes of the earnings and profits limitation of section 952(c), if a U.S. shareholder owns stock of a foreign corporation and by reason of such ownership owns stock of any other foreign corporation, and any such other foreign corporation has a deficit in earnings and profits for the taxable year, then the earnings and profits for the taxable year of each such foreign corporation that is a CFC shall, with respect to the U.S. shareholder, be properly reduced to take into account any such deficit in the manner the Secretary prescribes by regulations. The regulations for section 952(d) are contained in section 1.952-1(d) of the regulations.

Section 1.952-1(c)(2) of the regulations provides that to the extent a controlled foreign corporation's (the "first corporation") excess foreign base company shipping deductions for any taxable year (determined under section 1.955A-3(c)(2)(i)) reduce the foreign base company shipping income of another member of a related group, such deductions shall not be taken into account in determining the earnings and profits or deficit in earnings and profits of the first corporation for purposes of this paragraph (c) or

¹ Section 955(b)(2) was enacted as a part of the Tax Reduction Act of 1975, P.L. 94-12. The Tax Reduction Act of 1975 took section 955(b)(2) from a provision in a 1974 bill that was never enacted. H.R. Rep. 93-1502 accompanied the 1974 bill.

paragraph (d) of section 1.952-1. The rule of the preceding sentence shall not apply to the extent excess foreign base company shipping deductions of the first corporation reduce the foreign base company shipping income of another member of a related group below zero.

In this case, the excess foreign base company shipping deductions of [REDACTED] reduced the foreign base company shipping income of the other members of the related group below zero. To the extent [REDACTED]'s excess foreign base company shipping deductions are unused by the related group, [REDACTED] may use these excess deductions to determine its deficit in earnings and profits for purposes of the chain deficit rule of section 1.952-1(d) of the regulations. As a result of these unused excess deductions, [REDACTED] had a deficit in earnings and profits of \$ [REDACTED] that may be used to reduce the earnings and profits of other corporations in its chain, under section 952(d) of the Code.

CONCLUSION:

The related group election of section 1.955A-3 of the regulations applies for purposes of determining the foreign base company shipping income of members of the related group whether or not there has been an increase or decrease in qualified investments in foreign base company shipping operations of any member of the group.

The excess foreign base company shipping deductions of [REDACTED], for the taxable year [REDACTED], that are unused by members of its related group under section 1.955A-3(c)(2) of the regulations, may be used to determine whether [REDACTED] has a deficit in earnings and profits and any such deficit may reduce the earnings and profits of other members of Chain C, as provided in section 952(d).

If you have any questions about this memorandum, please call Valerie Mark at FTS 566-6645.

cc: [REDACTED]